MORALITY & LEGALITY OF CRYPTO CURRENCIES AND ICOS

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Initial Coin Offerings ("**ICOs**") and cryptocurrencies have been very much in the news and in many media and social media channels lately for various reasons. You may have read about how some ICOs have raised large sums of money over a short period of time. You may also have read the not insignificant bad press on some ICOs and even generally on cryptocurrencies.

Specifically, ICOs have been criticized by some as being a largely un-regulated means of raising funds by selling tokens amounting to "securities". There have also been allegations in the media that many ICOs have been and are a fraudulent means of raising funds, swindling and causing loss or potential loss to token purchasers.

What others say

A number of financial titans have spoken disparagingly of cryptocurrencies alluding to their lack of substance and also to the illegal purposes and terrorist financing to which their anonymity easily lends itself.

Famously, Warren Buffett, CEO of Berkshire Hathaway is on record calling bitcoin "rat poison squared" but in all fairness to him, he has been consistent in his pronouncements on bitcoin, including calling it a "mirage" and "tulips" and that it is "not a currency".

Continuing in this vein, Bill Harris of Intuit and PayPal has been quoted saying "Bitcoin is a scam. In my opinion, it's a colossal pump-and-dump scheme, the likes of which the world has never seen…

Cryptocurrency is best-suited for one use: Criminal activity.”.

Microsoft co-founder, Bill Gates has remarked that “The main feature of crypto currencies is their anonymity. I don’t think this is a good thing. The Government’s ability to find money laundering and tax evasion and terrorist funding is a good thing. Right now crypto currencies are used for buying fentanyl and other drugs so it is a rare technology that has caused deaths in a fairly direct way.”.

Former Chairman of the Federal Reserve, Ben Bernanke: “Bitcoin is an attempt to replace fiat currency and evade regulation and government intervention. I don’t think that’s going to be a success.”.

Away from the logistical nightmare of managing Brexit, Theresa May, Prime Minister of the United Kingdom said in a Bloomberg interview at Davos in January 2018: “Cryptocurrencies like Bitcoin, we should be looking at these very seriously precisely because of the way they can be used, particularly by criminals…”.

On the other hand, some other financial world leaders and gurus and even some government spokespersons have been less critical and more nuanced in their comments.
Christine Lagarde, the Managing Director of the International Monetary Fund said: “Not so long ago, some experts argued that personal computers would only be used as expensive coffee trays. So I think it may not be wise to dismiss virtual currencies.”. Countries with “weak institutions and unstable national currencies” may see growing use.

Haruhiko Kuroda, Governor, Bank of Japan said “Given that the development of financial services has been supported by ledgers as the basic infrastructure for information, the dramatic changes in how ledgers are kept may have the potential of significantly changing the structure of financial services.”.

Yet others have been positive and bullish on cryptocurrencies, even going so far as to regard the advent of cryptocurrencies as a positive development.

Starbucks Corporation Chairman and Founder, Howard Schultz said: “I believe that we are heading in to a new age in which blockchain technology is going to provide a significant level of a digital currency that is going to have a consumer application. And I believe that Starbucks is in a unique position to take advantage of that.”.

Jamie Dixon, JP Morgan Chase & Co, Chief Executive Officer said in an interview with Fox Business Network: “I regret making comments saying that Bitcoin is a fraud”. “The blockchain is real. You can have crypto yen and dollars and stuff like that.”.

Benoit Coeure, European Central Bank Executive Board Member remarked during a Davos panel discussion “We need better cross-border payments… because it’s good for development, it’s good for financial inclusion. So Bitcoin can help us, it can pay us a service by forcing us to upgrade our systems. That’s a positive lesson. The international community still needs to understand and control these gateways.”

It is apparent that cryptocurrencies (and ICOs) have a great number of famous critics who only have harsh words to say and condemnatory remarks to make. At the same time, some have come out to adopt a measured approach, including a “wait and see” philosophy. And there are some whose comments reflect the positive aspects of the technology that has enabled cryptocurrencies (and yes, this writer is in that camp).

The Managing Director of the Monetary Authority of Singapore (MAS), Ravi Menon has remarked: “Whether digital currencies will take off in a big way remains to be seen. But it is a phenomenon that many central banks are watching closely, including MAS. And if they do take off, one cannot rule out central banks themselves issuing digital currencies some day!”.

The moral dilemma

So here we are, with many in the financial world and business world having different views on cryptocurrencies, some diametrically opposite. Are they right? Are they wrong? I think neither is right or wrong in substance. We need to look at the subject matter coolly; and without the vial like feverish hullabaloo generated by cryptocurrencies and the monsoon rain surge of ICOs. In 2018 year to date, the number of ICOs already outnumber the total number of ICOs in 2017.

The blockchain

At the heart of Bitcoin and other cryptocurrencies is technology, viz. the ingenious blockchain. Basically, a digital distributed ledger system. The backbone advantage is the de-centralized nature of the ledger system. The data base in a blockchain is not stored in any central data base.

Instead information is held on a shared and therefore de-centralised data base. The blockchain is hosted and shared by all the computers in the network. Thus, any alteration to the information in the blockchain by a user is automatically updated throughout the blockchain and will be apparent to everyone else. The data stored on the blockchain is consequently, for all intents and purposes, incorruptible without being easily detected. So far, so good.

However, like any technology invented, the blockchain may be put to good use as well as to dubious use, or plainly, to further bad intentions. Its anonymous nature lends itself to being used to launder dirty money. Its anonymity in itself does not mean that blockchain and digital currency are immoral per se or necessarily illegal.

So how do we support and encourage the use of innovative technology with its myriad of potential applications (ranging from transmission of funds, logistics, healthcare, identity verification, document authentication, job market, real estate, cyber security, academic research and scientific articles, entertainment, philanthropy) without opening the floodgates to potential swindles by less than honest persons?

Both sides now

Persons seeking to raise funds for a project will typically launch an initial coin offering or token generation event (popularly referred to as an "ICO") whereby a special purpose vehicle (usually a company) is incorporated to be the token issuer which will offer for sale, to members of the public, its own tokens (or cryptocurrency). One of the reasons (not often mentioned in polite company) why many people seeking to raise funds will try to do so by an ICO is that an ICO is considered to be less regulated (people behind many of the early ICOs believed that an ICO was un-regulated by law) and therefore easier, faster and cheaper to launch when compared to other more conventional means of fund raising, like Initial Public Offerings ("IPOs") or borrowing from banks or from Private Equity funds and Venture Capital funding.

From the perspective of the average man in the street consumer, the most easily accessible means to participate is by purchasing new tokens in an ICO. However, many of the average man in the street will have only a vague idea of the risks involved and the level of risks attendant in buying a token in an ICO, as they are usually swayed by what they perceive as the upside "investment" value.

At the heart of the concerns which regulatory authorities in many countries have over ICOs is the relatively high risk posed to the consumer. In a typical ICO, whilst the tokens may be offered for sale and are purchased during a pre-sale and/or public sale phase, the blockchain platform on which the project for which the ICO is launched will not be up and running until some time after the tokens have been sold, which period of time may range from a few months to many months or even a year or more. The risk of enterprise failure therefore falls onerously on the token purchaser whilst the ICO company has secured its funds and may or may not be able (for various reasons) to build to completion the platform. Without the platform up and running, the tokens sold would be virtually useless, possessing no functions or uses.

Legal environment in Singapore

Many (if not most) of the ICOs launched claim to offer "utility" tokens rather than "securities" tokens. Whilst "utility" is not defined in any legislation in Singapore relating to the offering of tokens, tokens which are considered to be "securities" under Singapore law will be subject to and have to comply with the requirements in the Securities and Futures Act (Cap. 289). These requirements include the filing of a prospectus with the Monetary Authority of Singapore.

A matter of balance

This writer suggests some possible ways to mitigate enterprise failure risk and ameliorate financial loss to the public consumer (viz. the token purchasers) and offer reasonable protection to the consumer without unduly hamstringing the ambitions of genuine ICO aspirants.

Education

Like any new subject matter, education is key in helping people understand the basics of blockchain, cryptocurrencies and ICOs. An introductory course can be made compulsory for all persons who wish to participate in ICOs. The course can be run by a non-profit organization with a curriculum covering core topics for a token purchaser or token investor. Topics should include the ABCs of blockchain, cryptocurrency and ICOs and the nature and extent of the financial, fiscal and legal risks involved in buying tokens in an ICO.

Escrow arrangement

ICO aspirants may wish to consider taking only a part of the purchase price of each token (say 50%) as revenue upon the sale of a token and putting the rest in escrow with a third party escrow agent. The token issuing company would enter into an escrow agreement with the purchaser and an escrow agent. Legally, an escrow agreement would be structured such that the escrow sum will automatically be released to the token issuing company by the escrow agent when the blockchain platform is operational and functional as per the schedule in the relevant whitepaper. In the event that the blockchain platform is not operational and functional by the date stated in the relevant whitepaper, the escrow sum will automatically be returned to the token purchaser.

Accountability reports

ICO companies can issue an accountability report at regular intervals (say every week in the initial stage of the ICO, then every two weeks or each month when the ICO has reached its soft cap). The accountability report should be made available to all registered token purchasers and, possibly, also to whitelisted prospective token purchasers (ie. persons who have signed up to purchase tokens and who have been cleared through KYC procedures to be token purchasers). The contents of the report should include relevant information on the progress of the project, particularly on the completion status of the blockchain platform; and should also include the current amount of funds raised, the number of tokens issued and/or purchased; as well as any developments or news (factual, legal or fiscal) which may affect the tokens, their legality, value or tax status. The accountability report should also include updates on the listing process of the tokens and on collaborations with any intermediaries or business partners involved in the project or the token eco system.

Road Ahead

The ICO is and still can be an efficient means of raising capital for realising innovative ideas and implementing good business plans. However, those involved in the industry, including the entrepreneurs seeking to launch their ICOs, their professional advisors (ICO advisor, legal advisor, tax advisor, KYC service provider, publicity and media consultants); and all intermediaries (eg. exchanges, brokers and introducers) should be cognisant not only of the need to use a transparent approach to planning and rolling out an ICO; but also to ensuring that apart from just complying with or conducting their activities within the current law and regulations; they use or strive to establish best business practices in providing their advice and services. An ICO should never be regarded as a “get rich quick” scheme. The ICO can have a good future provided the people and proponents involved remain true to its original ethos, maintain requisite best practices in running their ICO and executing their business plan. The ICO can be a positive force if those involved in the business understand its objectives, its strictures and where possible recommend and implement improvements in the process to make it more understandable, efficient, transparent and risk-balanced.